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Leave requirement in securities class actions: "More than a speedbump, less than the Matterhorn"?

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Over the course of the past year, a series of instructive decisions from the Ontario courts has re-affirmed the role of the statutory leave requirement for secondary market misrepresentation claims as a robust gatekeeping tool. In so doing, the Ontario courts have confirmed their willingness to dispose of unmeritorious secondary market proceedings at a preliminary stage. In particular, the *Cronos* and *Peters* decisions illustrate that Ontario courts are increasingly prepared to engage in a meaningful assessment of the viability of proposed class actions seeking relief under Part XXIII.1 of the *Securities Act* (Ontario) (the Securities Act) at the preliminary leave stage, in contrast to the more reserved approach exhibited in the context of the underlying motions for class certification. Similarly, the *Pretium* decision illustrates the courts' willingness to dispose of proposed securities class actions on the basis of a summary judgment motion, even where leave under the Securities Act had previously been granted.

Taken together, these cases confirm that the courts are becoming increasingly interventionist in their role as gatekeepers, particularly in the context of unmeritorious secondary market claims. These trends should be of some comfort to issuers. The courts' interventionist approach will hopefully deter plaintiffs from commencing plainly untenable claims and demonstrate the benefits to defendants of using available tools, such as the leave requirement or summary judgment, to bring a prompt end to such claims.

All three decisions also provide useful guidance as to what courts will consider "material" when determining whether an actionable misrepresentation has been communicated. At the leave stage, the failure to plead misrepresentations with precision or without sufficient evidence can be fatal to a plaintiff's leave motion. The reliability of information (including the expertise of the party providing it) is critical in determining whether the information will be considered "material."

Statutory basis for secondary market liability

In Ontario, the rules that govern secondary market liability are set out in *Part XXIII.1 — Civil Liability for Secondary Market Disclosure* of the Securities Act. Substantially similar provisions have been adopted in other provincial securities statutes. Misrepresentation claims under the Securities Act allow secondary market investors to claim damages for misrepresentations in an issuer's continuous disclosure documents or public statements without requiring proof of a duty of care or reliance. Whether a statement or omission may qualify as a "misrepresentation" under the Securities Act depends on the materiality of the misstatement or omission, as a misrepresentation applies in respect of a "material fact." Under the Securities Act, a material fact is "a fact that would reasonably be expected to have a significant effect on the market price or value of the securities."

An action for secondary market misrepresentation under the Securities Act requires leave of the court. The court will only grant leave if it is satisfied that the action is brought in good faith and "there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff." In *Theratechnologies*, the Supreme Court of Canada articulated the applicable legal test for leave in 2015, stating that it is intended to be a "robust deterrent screening mechanism" and must amount to more than a "speed bump." To meet the threshold, the plaintiff bears the onus of proof. The plaintiff must provide a plausible analysis of the applicable legislative provisions, and credible evidence in support of the claim.

In *Theratechnologies* and the *Canadian Imperial Bank of Commerce* decisions, the Supreme Court of Canada also confirmed that the test for obtaining leave is different from – and imposes a higher threshold than – the test for the authorization or certification of a class action.

The courts affirm their gatekeeping role in recent decisions (2021)

The Cronos decision

In both *Cronos* and *Peters*, the courts denied the respective plaintiffs' motions for leave to proceed with statutory misrepresentation claims under the Securities Act and, by extension, their companion motions for certification pursuant to the *Class Proceedings Act, 1992*. In reaffirming the gatekeeping function of the leave test under the Securities Act, both cases raise interesting questions about the threshold for materiality.

In *Cronos*, the plaintiff asserted 7,449 allegations of misrepresentation related to certain financial transactions undertaken by Cronos, a cannabis company, resulting in improperly recognized revenues. The company later admitted in restated financial statements and MD&As that, in connection with the revenue recognition issues, there were material weaknesses in its internal controls over financial reporting which it had previously disclosed as functioning.

At the outset of his reasons, Justice Morgan clarified that the leave requirement was one that "open[s] the door to a more substantive rather than strictly procedural evaluation of the claim." By contrast, the motion judge is prohibited from assessing the strength of the claim at the certification stage.

Justice Morgan refused leave, finding that nothing in the record demonstrated that the thousands of alleged misrepresentations could reasonably be expected to have a significant effect on the market price or value of Cronos' securities. Importantly, in coming to his decision, Justice Morgan noted that "a restatement of financials may be evidence of a prior misstatement, but it is not so weighty that it overrides the evidence of the materiality experts who have concluded that any such corrections had little to no market impact. […] [M]ateriality is in the eye of the investors, not the accountants."

In this particular instance, the evidence of materiality provided by the plaintiffs was all but non-existent. According to Justice Morgan, any evidence that did exist was "weak" and tended to "confuse market-wide movements in share prices, especially those coinciding with the March 2020 onset of the COVID-19 pandemic, with company-specific movements." Accordingly, he concluded that the failure of the plaintiff to precisely plead the misrepresentations, combined with the dearth of evidence of materiality, was fatal to the plaintiff's ability to show that there was a reasonable possibility of establishing at trial that the alleged misrepresentations were material.

Turning to certification, Justice Morgan considered the plaintiff's common law claims for negligent misrepresentation and statutory claim of oppression pursuant to Ontario's *Business Corporations Act*. These claims were swiftly dismissed on the basis that the plaintiff failed to plead adequate and particularized material facts to ground his claim. According to Justice Morgan, the misrepresentation claims against Cronos, whether framed in statutory or common law terms, were devoid of particulars about which misrepresentation caused loss. On this basis, both the leave and certification motions were dismissed.

The Peters decision

In *Peters,* Justice Perell similarly refused the plaintiff's motions for leave to proceed under the Securities Act and for certification. In this case, the plaintiff alleged that SNC had failed to disclose a material change when it did not disclose the Director of Public Prosecutions of Canada's decision not to invite SNC to negotiate a Remediation Agreement.

In this regard, Justice Perell noted that the fundamental fallacy in the plaintiff's argument was that it applied a material *fact* analysis and not a material *change* analysis. The plaintiff's legal analysis ignored the fundamental principle that "material facts" are a broader concept than a "material change," which is limited to "a change in the business, operations or capital of the issuer." Conversely, "material facts" encompass "any fact that reasonably would be expected to have a significant effect on the market price or value of the securities of an issuer," beyond matters that affect the business, operations or capital of the issuer.

Justice Perell noted that "no single factor such as share price movement will conclusively determine whether a material change has occurred." Thus, an actionable failure to disclose a material change requires more than just a change followed by a share price decline. Ultimately, Justice Perell found that because the evidence before him did not credibly point to a material change that could have triggered timely disclosure obligations, there was no reasonable possibility that the plaintiff's action under the Securities Act could succeed.

Justice Perell also dismissed the motion for certification on the basis that, given that leave was not granted for the statutory misrepresentation claim, it naturally followed that the statutory claim could not be certified as a class proceeding. On the common law negligent misrepresentation claims, Justice Perell stated where leave to assert a statutory claim under theSecurities Act has been denied, a common law claim based on the same alleged misrepresentation will not satisfy the preferable procedure criterion and thus will not be certified.

More than a speed bump, but not the Matterhorn

It is settled law that defendants are not required to lead evidence on the leave motion. The burden rests solely with the plaintiffs, reflecting the underlying policy that the leave requirement "was not enacted to benefit plaintiffs or to level the playing field for them in prosecuting an action under Part XXIII.1," but rather to protect defendants from coercive litigation and to reduce their exposure to costly proceedings. This policy rationale is reflected in both the *Cronos* and *Peters* decisions.

Notably, the first decision on the merits in respect of a secondary market misrepresentation claim, released this year, evidenced a similar approach by the courts. In *Pretium*, Justice Belobaba summarily dismissed the plaintiff's claim, finding that the defendants had not made any misrepresentation by omission and that, in any event, the defendants had a valid reasonable investigation defence. Justice Belobaba concluded that, while the plaintiff was able to meet the test for leave to proceed under the Securities Act, he did not prove on a balance of probabilities that there was a misrepresentation or reliance. In other words, even

where the leave test had been satisfied, the court was still prepared to dispose of the proceeding on a summary basis following a preliminary assessment of the underlying merits.

The plaintiff in *Pretium* alleged that Pretium committed a misrepresentation by omission when it refused to disclose a negative opinion from one of its consultants regarding the viability of its mine. At the leave motion, Justice Belobaba held that reasonable investors would have considered it material that Pretium's mining consultants fundamentally disagreed as to whether there were valid mineral resources at Pretium's new mine. However, in the face of new evidence presented at the cross-motions for summary judgment, Justice Belobaba found that the underlying opinion was unsolicited, inexpert, premature and unreliable. On the basis that objectively unreliable or erroneous opinions are not material facts, he further concluded that there was no misrepresentation.

At the outset of his decision, Justice Belobaba confirmed the distinction between the evidentiary standard at the leave stage as compared to the adjudication of the merits. He noted that he had granted the plaintiff leave because there was enough evidence provided at that stage to meet the "reasonable possibility of success" hurdle. As Justice Belobaba noted, while the leave motion is "more than a speed bump, it is not the Matterhorn." On the merits, however, the plaintiff must meet the higher standard of a "balance of probabilities." On the facts before him, he ultimately concluded that the plaintiff simply could not satisfy the higher evidentiary standard and granted summary judgment accordingly.

Key takeaways

Taken together, *Cronos*, *Peters* and *Pretium* are helpful illustrations of the courts' willingness to engage with the merits of proposed secondary market misrepresentation cases and – where such claims are found wanting – to dispose of them at an early stage in their role as gatekeepers. Indeed, this judicial role continues even after leave has been granted, such that a plaintiff's success at the leave stage does not necessarily preclude a defendant's success on the merits.

These decisions also highlight the importance of the materiality threshold for actionable alleged misrepresentations contained in public disclosures. A failure to properly plead the alleged misrepresentations with sufficient precision or without sufficient evidentiary support – including expert evidence speaking to the materiality of the statements or omissions – may be fatal to a plaintiff's request to proceed with a secondary market action.